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VERSUS Incomco, et al.

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**PETITION  
FOR WRIT OF  
CERTIORARI**

① 83 - 2025

Office - Supreme Court, U.S.

FILED

JUN 11 1984

ALEXANDER L. STEVAS.  
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No.

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In The

**Supreme Court of the United States**

October Term 1984

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**MONTE R. MORDAUNT and DOROTHY MORDAUNT,  
PETITIONERS,**

vs.

**INCOMCO, a partnership, and MYRON J. SMITH and  
PHILLIP M. SMITH, general partners**

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**PETITION FOR A WRIT OF CERTIORARI TO THE UNITED  
STATES COURT OF APPEALS FOR THE NINTH CIRCUIT**

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**John R. Quinlan  
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3922

### **QUESTION PRESENTED**

1. Whether a discretionary commodities trading account, where there is indicia of pooling, is an investment contract thus falling under the definition of a "security" for purposes of the Securities Act of 1933 and the Securities Exchange Act of 1934.

## PARTIES TO THE PROCEEDING

The parties here listed are all of the parties to this action.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED  
STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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John R. Quinlan, attorney at law, on behalf of Monte R. Mordaunt, and Dorothy Mordaunt petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this cause.

**OPINIONS BELOW**

The opinion of the Court of Appeals (App C, *infra*) is reported at 686 F.2d 815. The decision of the District Court (App E, *infra*) is not reported.

**JURISDICTION**

The judgment of the Court of Appeals was entered on March 21, 1984. (App D, *infra*). The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1). /

## STATUTORY PROVISIONS INVOLVED

1. §2(1) of The Securities Act of 1933. Act of May 27, 1933, c. 38, Title I, §2(1), 48 Stat. 74, as amended by Pub. L. 97-303, §1, 96 Stat. 1409, and codified at 15 U.S.C. §77b(1):

The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

15 U.S.C. 77b(1) at 10.

The definition of a "security" under Idaho Code §30-1402(12) is substantially the same as the Federal definition.

2. §3(a)(10) of The Securities Exchange Act of 1934, Act of June 6, 1934, c. 404, Title I, §3(a)(10), 48 Stat. 883-4, as amended by Pub. L. 97-303, §2, 96 Stat. 1409, and codified at 15 U.S.C. §78c(10):

(10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim

certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

15 U.S.C. §78c(10) at 385.

## STATEMENT OF THE CASE

1. The Securities Act of 1933 and the Securities Exchange Act of 1934 were implemented to protect the investing public from fraud and to promote fair dealing and ethical standards of honesty in public offerings of securities in commerce. *Ernst and Ernst v. Hochfelder*, 425 U.S. 185 (1976), *reh'g denied* 425 U.S. 986 (1976).

Whether something is a "security" for purposes of falling under the purview of these Acts is a question of federal law.

The definition of a "security" under these Acts is broad and has been liberally construed by the courts in order to implement the Acts' remedial purpose of protecting the investing public. *S.E.C. v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476 (9th Cir. 1973), *cert. denied*, 414 U.S. 821 (1974). 15 U.S.C. 77b; 15 U.S.C. 78c(10) provides the definition of a "security" which includes an investment contract.

2. Plaintiffs Dorothy Mordaunt and Monte B. Mordaunt, mother and son, filed suit in the United States District Court for the District of Idaho against Incomco, a partnership, and its general partners, Myron J. Smith and Philip M. Smith (herein Incomco). The Mordaunts prayed for damages based upon the use of false, inaccurate, misleading, and deceptive information by Incomco to sell the Mordaunts certain securities in violation of 15 U.S.C. §77e, 15 U.S.C. §77q and Idaho Code §30-1403,<sup>1</sup> which were not registered as required by The Se-

1/ The term 'securities' is defined by the Securities Act of 1933, The Securities Exchange Act of 1934, and The Idaho Securities Act. 15 U.S.C. §77b; 15 U.S.C. §78c(a); Idaho Code §§30-1403, *et seq.* The term in the federal acts is to be constructed and interpreted in the same manner. *Tcherepin v. Knight*, 389 U.S. 332 (1967).

curities Act of 1933 and The Idaho Securities Act. 15 U.S.C. §77e and Idaho Code §§ 30-1403, *et seq.* Jurisdiction of the District Court was premised upon 15 U.S.C. §78aa and 28 U.S.C. §1331(a) regarding claims arising under The Securities Act of 1933 and The Securities Exchange Act of 1934 and upon pendent jurisdiction regarding claims arising under the Idaho Securities Act.<sup>2</sup> The District Court entered its decision and judgment on September 8, 1978.(App. D, *infra*).

The District Court found that the Mordaunts relied upon advertisements published on behalf of Incomco and representations by an employee of Incomco and Mr. Philip Smith, which were false, misleading, deceptive, inaccurate, or in varying combinations thereof, in entering into discretionary commodities contracts with Incomco (App E at E6, *infra*). Under this arrangement the Mordaunts invested their money (\$14,349.00 and \$32,610.00, respectively) and Incomco had the discretion to utilize the funds to trade in the commodities market, which it did. Incomco had a large number of such accounts and purchased a number of commodity 'contracts' at one time which were then specifically assigned to the account of an individual investor and so reported to the investor. (App E at E2, E3, *infra*). In essence, the funds supplied by investors were pooled by Incomco. Profits to investors and consequent additional commissions earned by Incomco depended solely upon the skill of Incomco in predicting the market.(App E at E3, *infra*).

The District Court concluded that:

1) The transactions between the parties constituted investment contracts for the purchase of securities under both the federal and state securities acts;

2) Incomco sold to the Mordaunts unregistered securities in violation of the said federal and state securities acts;

3) The information contained in the advertising sales documents sent by Incomco to the Mordaunts contained false and misleading statement as to material facts in violation of

2/ There is no issue before the Court concerning that portion of the judgment relating to state law. The opinion of the Court of Appeals did not address that aspect of the District Court's judgment. (App C, *infra*).

the said federal and state securities acts and Rule 10b-5 of the Securities and Exchange Commission; and,

4) The Mordaunts reasonably relied upon these false statements to their detriment. (App E at E6, *infra*).

Incomco thereafter sought review in the United States Court of Appeals for the Ninth Circuit with the jurisdiction of that court being based upon 28 U.S.C. §1291. The cause was argued and submitted on October 14, 1980. The submission was withdrawn on March 25, 1981 and reinstated on June 2, 1982. The Court of Appeals issued its decision on September 9, 1982, reversing the judgment of the District Court that the discretionary commodities contracts between the Mordaunts and Incomco were investment contracts under federal law. (App C, *infra*). The Mordaunts moved for rehearing, which was denied. The judgment of the Court of Appeals was issued on March 21, 1984. (App B, *infra*). The Court of Appeals held that the discretionary commodities contracts between the Mordaunts and Incomco were not investment contracts because the element of "common enterprise", as required by the test enunciated by this Court in *S.E.C. v. W. J. Howey Co.*, 328 U.S. 293, 298-9 (1946), was absent.<sup>3</sup> (App C, at C4, *infra*). The opinion of the Court of Appeals was based entirely upon its prior opinion in *Brodt v. Brache & Co., Inc.*, 595 F.2d 459 (9th Cir. 1978), *reh'g denied* (1979), where it rejected a claim that a discretionary commodities trading account constituted a "common enterprise" on the basis that there was no direct relation between the success or failure of the promoter and that of the investors. (App C, at C4, *infra*).

3/ The Court of Appeals rejected the argument by Incomco that the District Court lacked subject matter jurisdiction because exclusive jurisdiction over transactions and accounts involving contracts for the sale of commodities for future delivery is vested with Commodities Trading Commission pursuant to 7 U.S.C. §2. The Court of Appeals felt such a holding would be inconsistent with the opinion of the Court in *Merrill Lynch Pierce Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1983).

## REASONS FOR GRANTING CERTIORARI

This case presents important public policy questions by seeking further explication of the application of the test this Court laid down in *S.E.C. v. W. J. Howey, supra*, concerning the definition of an investment contract as a "security" for purposes of The Securities Act of 1933 and The Securities Exchange Act of 1934. These questions arise because the purpose of these Acts is to protect the investing public from fraud and misrepresentation upon the public offering of a "security". *Ernest and Ernest v. Hochfelder, supra*.

This case specifically seeks a resolution of the distinct split between the various Circuit Courts on the issue of whether a discretionary commodity trading account, where there is indicia of pooling, is an investment contract within the definition of a "security".

### 1. PUBLIC POLICY CONCERNS.

Both the Securities Act of 1933 and the Securities Exchange Act of 1934 have as their essential purpose the protection of the investing public. *S.E.C. v. Glenn W. Turner Enterprises, supra*; *S.E.C. v. Kaplan*, 397 F.Supp. 564 (E.D. N.Y. 1975). Both investors and promoters, whether large or small, need to be certain of whether or not their actions are covered by the Securities Acts. Presently, either investors or promoters can only predict the outcome of this question, as it relates to the definition of an investment contract, by what Circuit any litigation would happen to come in. Because of the current unsettled state of the law, it is impossible to effectively make important factual determinations regarding either the purchase or sale of a security. The Circuits are split and there is conflict between decisions of regulatory agencies and Courts of Appeals and District Court.

## 2. SPLIT OF AUTHORITY AMONG CIRCUIT COURTS OF APPEAL

The petitioner's primary objective is to get his money back. In pursuing that goal, petitioner seeks resolution of the split of authority between the Circuit Courts of Appeal.

The 6th, 7th, and 9th Circuits hold that discretionary commodities futures trading accounts are not investment contracts and hence are not securities. The 2nd, 5th, 8th, and 10th Circuits hold that such accounts are investment contracts and thus are securities.

Further illustration of confusion in this area is given in cases where the S.E.C. has brought the action. See *S.E.C. v. Continental Commodities Corp.*, 497 F.2d 516 (5th Cir. 1974), and *S.E.C. v. Glenn W. Turner Enterprises, supra*. In both cases the "vertical commonality" test was applied. Yet in *Texas-Arizona Mining Co.*, [1971-1972 Transfer Binder] C.C.H. ¶78, 626 (Feb. 2018, 1972), the S.E.C. seemed to acquiesce in the doctrine that a commodity futures contract (vertical commonality) was not a security.<sup>4</sup>

The S.E.C. regulates all of the stock exchanges in the United States. However, because of this vertical-horizontal commonality conflict in the different Circuits, it is forced to use two sets of rules. What is a security in one circuit may not be a security in another, even though a "security" is defined by federal legislation and regulated by a federal agency. The

4/ The importance of having the question settled for the public is further illustrated by Congress's establishment of the Commodity Futures Trading Commission. The General Counsel for the Commission issued an opinion, (CFTC Interpretative Letter No. 77-2 (1975-1977 Transfer Binder) CCH Comm. Fut. L. Rep. 20, 257 at 21, 371 (1977)) that the commission had exclusive jurisdiction over both discretionary and nondiscretionary commodities futures contract. The Securities Exchange Commission attempted to limit the jurisdiction of the Commodity Futures Trading Commission. The two commissions reached agreement whereby the SEC would regulate options on securities, certificates of deposit and foreign currencies traded on national securities exchanges and the CFTC would regulate futures contracts on exempted securities and broad-based indices of stock prices, as well as options on such futures contracts and options on foreign currencies in the commodity markets.

commentators and annotators have the same problem. See 58 A.L.R.Fed. 616, Annot. (1967); 3 A.L.R.Fed. 592, Annot. (1982); Wolfson, Phillips, Russo, *Regulation of Brokers, Dealers & Securities Markets*, §1.1 5, p.1-30, 1983 Supp. §1.15, p.1-13. As a result, this controversy among the various circuits needs a final clarification by this Court.

The source of the authoritative definition of an investment contract is found in the opinion *S.E.C. v. W.J. Howey, supra*, where this Court defined it as a:

... contract, transaction or scheme whereby the person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party.

An equally significant holding of *Howey*, is that form is to be disregarded for substance and that the investment contract concept ...

[e]mbodies a flexible rather than static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of money of others on the promise of profits. *Howey, supra* at 299.

In the *United Housing Foundation, Inc. v. Forman* 421 U.S. 837 (1975), *reh'g denied*, 422 U.S. 884 (1976), the court restated the *Howey* formula and reiterated earlier statements that a determination of securities characterization should be based not on the literal terms of the statute but on "the economic realities underlying a transaction." *Id.* at 849.

Two distinct lines of authority have emerged on the issue of whether a discretionary trading account in commodities futures is a security. This split among the Circuit's results primarily from a disagreement over what meaning to give the words "common enterprise" for the purposes of the "Howey" test. One line of cases maintains that there must be a pooling of funds, or pro-rata sharing of profits in order for a "common enterprise" to exist. The other line of cases, however, has construed "common enterprise" to mean that the investor must provide the capital for a mutual venture controlled by the promoter.

a) 6th, 7th, and 9th Circuits: "Horizontal Commonality".

In *Milnarik v. M.S. Commodities, Inc.*, 457 F.2d 274 (7th Cir. 1972), *cert. denied*, 409 U.S. 887 (1972), the court held that a discretionary trading account in commodity futures was not a security. This conclusion was based on a finding that a common enterprise was lacking despite the fact that the defendants had entered into similar arrangements with other investors. The court viewed the defendants' relationship with each investor as that of agent and principal because each account was unitary in nature and the success or failure of one account had no direct impact on the others.<sup>5</sup> The Seventh Circuit reaffirmed *Milnarik* in *Hirk v. Agri-Research Council, Inc.*, 561 F.2d 96 (7th Cir. 1977) and held, on similar facts, that a pooling of the investors' funds or sharing of profits was required for a common enterprise to exist. See also, *Glazer v. Nat'l Commodity Research & Statistical Servs.*, 388 F.Supp. 1241 (N.D.Ill. 1977).

The Ninth Circuit followed *Hirk v. Agri-Research Council, Inc., supra*, in *Brodt v. Bache, supra*, where it stated:

This Court has defined 'common enterprise' as one in which the 'fortunes of the investor are interwov-

5/ All that has happened is that the so-called "buyer" has transferred funds to the so-called "seller" and given his discretionary authority to enter into future transactions on the "buyer's" behalf. In essence, this contract creates an agency-for-hire rather than constituting the sale of a unit of a larger enterprise. No matter how many different persons Nelson became an agent for under similar or even identical discretionary contracts, his relationship with each would remain as that of agent and principal. Each contract creating this relationship is unitary in nature and each will be a success or failure without regard to the others. Some may show a profit, some a loss, but they are independent of each other. No matter how many discretionary trading accounts Nelson may have had with other principals, the "security" "issued" to the plaintiffs, their discretionary trading account, could not be offered to anyone else. Although this Court recognizes that the registration requirements of Section 5 are for the protection of the public and that any exemption therefrom must be strictly construed against one claiming it, *S.E.C. v. Ralston Purina Co.*, 346 U.S. 119, (1953); *S.E.C. v. Culpepper*, 270 F.2d 241 (2d Cir. 1959), the unitary nature of the contract here involved is not overcome even when the transaction is viewed most strongly against the defendants. Citing *Milnarik*, at 276-277.

en with and dependent upon the efforts and success of those seeking the investment or of third parties. *S.E.C. v. Glen W. Turner Enterprises, Inc.*, 474 F.2d 476, 482 (9th Cir. 1973)

The Ninth Circuit went on to explain that it required a "strict pooling requirement" which was consistent with the Seventh Circuit in *Milnarik v. M-S Commodities, Inc.*, *supra*, *Hirk v. Agri-Research Council, Inc.*, *supra*. The Court also said:

This pooling of interests, usually combined with a pro-rata sharing of profits, has been characterized as "horizontal commonality." *Brodt v. Bache and Co., Inc.*, *supra* at 460.

The Ninth Circuit in the instant case followed *Brodt v. Bache and Co., Inc.*, *supra*, and added:

In sum, these discretionary commodities trading accounts do not constitute common enterprise, and therefore are not securities under 15 U.S.C. §77b. (App C, at C4, *infra*).

The Sixth Circuit in *Curran v. Merrill Lynch Pierce Fenner & Smith, Inc.*, *supra*, *cert. granted*, 415 U.S. 906 (1980) adopted the *Milnarik*, *supra*, "horizontal commonality" approach and concluded that a "discretionary commodity account is not a security."<sup>6</sup>

b) 2nd, 5th, 8th & 10th Circuits: "Vertical Commonality".

The other side of this split of authority is represented by those courts which have found that a discretionary commod-

6/ Other courts adopting the "horizontal commonality" approach are *Wasowic v. Chicago Board of Trade*, 352 F.Supp. 1066 (M.D.Pa. 1972) *aff'd without opinion* 491 F.2d 752 (3rd Cir.) *cert. denied*, 416 U.S. 994, (1974); *Berman v. Bache, Halsey, Stuart, Shields Inc.*, 467 F. Supp. 311 (S.D. Ohio, 1979).

ities trading account does possess the requisite commonality for an investment contract.<sup>7</sup>

In *S.E.C. v. Continental Commodities Corp.*, *supra*, the Fifth Circuit specifically rejected the *Milnarik* view, (7th Circuit's "horizontal commonality") and warned against "elevation of a pooling agreement to exalted status in inquiries concerning a common enterprise, and reiterated the Ninth Circuit definition of "common enterprise." The Court stated:

Were this view compatible with pronouncements of the Supreme Court and this Circuit, then the district court's reasoning would be compelling. However, we cannot accept the *Milnarik* view. In *S.E.C. v. Koscot Interplanetary, Inc.*, *supra*, this court decried a limitus application of the *Howey* test and expressed its preference for a resilient standard which could comport with the uniformly acclaimed remedial purposes of *The Securities Act of 1933* and *The Securities Exchange Act of 1934*. While primarily concerned with explicating the contours of the "solely from the efforts of others" element, we had occasion to consider the parameters of the common enterprise element as well. There, we endorsed the Ninth Circuit's formulation that "[a] common enterprise is one in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of third parties." *supra* at 278, *S.E.C. v. Koscot Interplanetary, Inc.*, *supra* at 278, quoting *S.E.C. v. Glen W. Turner Enterprises*, 474 F.2d 476, 482 n. 7 (9th Cir.), *cert. denied*, 414 U.S.

7/ *Booth v. Peavey Co. Commodities Services*, 430 F.2d 132, 133 (8th Cir. 1970); *Commercial Iron & Metal Co. v. Bache and Co.*, 478 F.2d 39 (10th Cir. 1973), *cert. denied*, 440 U.S. 914 (1979); *Miller v. Central Chinchilla Group, Inc.*, 494 F.2d 414 (8th Cir. 1974); *S.E.C. v. Continental Commodities Corp.*, *supra*; *Johnson v. Arthur Espey, Shearson Hammill & Co.*, 341 F.Supp. 764 (S.D.N.Y. 1972); *Mahue v. Reynolds & Co.*, 282 F.Supp. 423 (S.D.Iowa 1967); *Marshall v. Lamson Bros. and Co.*, 368 F.Supp. 486 (S.D.N.Y.1968); *Savino v. E.F. Hutton Co., Inc.*, 507 F.Supp. 1225 (S.D.N.Y. 1981); *Troyer v. Karcagi*, 476 F.Supp. 1142 (S.D.N.Y. 1979).

821, (1974), "[t]he critical factor is not the similitude or coincidence of investor input, but rather the uniformity of impact of the promoter's efforts." *S.E.C. v. Koscot, supra* at 478 . . .

[T]he critical inquiry is confined to whether the fortuity of the investments collectively is essentially dependent upon promoter expertise. Continental Commodities renders investment counseling concerning which option on commodities futures to invest in, when to sell or exercise the option, and if the option is exercised, when to sell the specific futures contract. Lacking the business acumen possessed by promoters, investors inexorably rely on Continental Commodities' guidance for the success of their investment. This guidance, like the efficacy of *Koscot* meetings and guidelines on recruiting prospects and consummating a sale, is uniformly extended to all its investors. That it may bear more productive fruits in the case of some options than it does in cases of others should not vitiate the essential fact that the success of the trading enterprise as a whole and customer investments individually is contingent upon the sagacious investment counseling of Continental Commodities. *Id.*

The common enterprise language is not necessary under *Howey, supra*. In *Taylor v. Bear Stearns & Co.*, 572 F.Supp. 667 (N.D. Ga. 1983) the court states:

Here allegations of defendant's dominance of the relationship exists. Such a dominance provides commonality. See *SEC v. Continental Commodities Corp.*, 497 F.2d at 522-23 (5th Cir. 1974). Given plaintiff's expectation that defendants were his investment managers, there exists a one-to-one relationship or a vertical commonality. (Emphasis added). *Surino(sic) v. E.F. Hutton and Co. Inc.*, 507 F.Supp 1225, 1237 (S.D.N.Y. 1981); *Alvord v.*

*Shearson Hayden Stone, Inc.*, 485 F.Supp. 848, 853. (D. Conn.1980). The reasoning of the *Savino, supra*, court is persuasive.

The Court agrees that a 'common enterprise' should be found to exist within the meaning of *Howey* where there is vertical commonality as described in *Turner and Brodt*. The test set forth in *Howey*, as the Court itself there stated, embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits. *SEC v. W.J. Howey, supra*, 328 U.S. at 299. By its terms, the common enterprise component of the *Howey* test states merely that the financial relationship that is to be labeled an 'investment contract' must include two or more parties whose profits or losses are interdependent to a certain extent. The Securities Exchange Commission has stated:

(A) These 'naked options' were 'securities within the meaning of that term as used in *The Securities Act of 1933*. . . 'A common enterprise is one in which the fortunes of the investor are interwoven with and dependent on the efforts and success of those with whom he invests.' *In Re Carlson* (1977 SEC) Release No. 14246 Dec. 27, 1977, SEC Docket Vol 13, No. 15 p. 1104.

### CONCLUSION

For the foregoing reasons, the opinion of the Court of Appeals should be reviewed to resolve the split of authority between the Circuit Courts, District Courts, and Securities & Exchange Commission as to whether a discretionary commodities futures account is an investment contract. Therefore, this petition for certiorari should be granted.

Respectfully submitted,

  
JOHN R. QUINLAN

Paine, Hamblen, Coffin &  
Brooke  
1200 Washington Trust  
Financial Center  
Spokane, Washington 99204

### APPENDIX A UNITED STATES COURT OF APPEALS

#### FOR THE NINTH CIRCUIT

MONTY R. MORDAUNT, an individual, and No. 78-3499  
Dorothy Mordaunt, an individual,  
Plaintiffs-Appellees, ORDER

vs.

INCOMCO, a partnership, MYRON J.  
SMITH and PHILIP M. SMITH, general  
partners,  
Defendants-Appellants.

FILED  
United States  
Court of Appeals  
for the  
Ninth Circuit  
MAR 13, 1984  
Phillip B.  
Windberry  
Clerk

Before: SKOPIL and POOLE, Circuit Judges, and HALBERT,\*  
District Judge

The panel as constituted in the above case has unanimously voted to deny the petition for rehearing.

The petition for rehearing is denied.

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\*The Honorable Sherrill Halbert, Senior United States District Judge, for the Eastern District of California, sitting by designation.

**APPENDIX B**  
**UNITED STATES COURT OF APPEALS**  
**FOR THE NINTH CIRCUIT**

MONTY R. MORDAUNT, an individual, and  
 Dorothy Mordaunt, an individual,  
 Plaintiffs-Appellees

No. 78-3499  
 DC CV 03-75-  
 0068 RM

vs.

JUDGMENT

INCOMCO, a partnership, MYRON J.  
 SMITH and PHILIP M. SMITH, general  
 partners,

Defendants-Appellants.

FILED  
 U.S. District  
 Court District of  
 Idaho  
 MAR 27, 1984  
 Jerry L. Clapp,  
 Clerk

APPEAL from the United States District Court for the District of Idaho (Moscow).

THIS CAUSE came on to be heard on the Transcript of the Record from the United States District Court for the District of Idaho (Moscow) and was duly submitted.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court, that the judgment of the said District Court in this Cause be, and hereby is, reversed.

Filed and entered September 9, 1982

**APPENDIX C**  
**UNITED STATES COURT OF APPEALS**  
**FOR THE NINTH CIRCUIT**

MONTE R. MORDAUNT, an individual,  
 and Dorothy Mordaunt, an individual,  
 Plaintiffs/Appellees,

No. 78-3499  
 DC #CV3-75-  
 68-RM Idaho

vs.

OPINION

INCOMCO, a partnership, MYRON J.  
 SMITH and PHILIP M. SMITH, general  
 partners,

Defendants/Appellants.

FILED  
 United States  
 Court of  
 Appeals,  
 Ninth Circuit  
 SEP 9, 1982  
 Philip B.  
 Winberry  
 Clerk

Appeal from the United States District Court  
 for the District of Idaho

Honorable Ray McNichols,  
 Chief District Judge, Presiding  
 Argued and submitted October 14, 1980  
 Submission withdrawn March 25, 1981  
 Resubmitted June 2, 1982

Before: SKOPIL and POOLE, Circuit Judges, and HALBERT,  
 District Judge.\*

POOLE, Circuit Judge.

Incomco, a partnership engaged in the brokerage of commodities futures contracts, and its two general partners' appeal a judgment of the district court awarding damages, interest and attorneys' fees to Monte and Dorothy Mordaunt.

\*The Honorable Sherrill Halbert, Senior United States District Judge for the Eastern District of California, sitting by designation.

The Mordaunts opened discretionary commodities trading accounts with Incomco. When their accounts proved unsuccessful, the Mordaunts withdrew their money. They then filed suit alleging violations of federal and state securities laws. After a bench trial, the district judge found that Incomco had violated federal and state securities laws and entered judgment for the Mordaunts. This appeal followed. We reverse.

### Jurisdiction

Incomco first argues that the district court lacked subject matter jurisdiction because the Commodities Exchange Act, 7 U.S.C. §§1-24, vests exclusive jurisdiction over actions arising out of "accounts, agreements . . . and transactions involving contracts of sale of a commodity for future delivery" in the Commodities Futures Trading Commission. *Id.* §2. We disagree. In *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, the Supreme Court held that the 1974 amendments to the Commodities Exchange Act did not extinguish a private cause of action for persons injured by a violation of the act, a holding inconsistent with a finding that jurisdiction over the Mordaunts' claims rest exclusively in the Commission. \_\_\_\_\_ U.S. \_\_\_\_\_, 102 S.Ct. 1825 (1982).

### "Securities"

The Mordaunts were entitled to prevail in the district court only if the discretionary commodities trading accounts they opened with Incomco were "investment contracts" and therefore "securities" within the meaning of 15 U.S.C. § 77(b). Incomco argues that the district court erred in so holding. We agree. The district court did not have the guidance of our decision in *Brodt v. Bache & Co.*, 595 F.2d 459 (9th Cir. 1978), filed after entry of judgment in this case. *Brodt* is dispositive and therefore the judgment of the district court must be reversed.

The district court held that discretionary commodities trading accounts are subject to regulation as "investment contracts" under 15 U.S.C. §77(b). An investment contract is defined as a "contract, transaction or scheme whereby a per-

son invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party." *SEC v. W. J. Howey Co.*, 328 U.S. 293, 298-99 (1946). See *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551, 558 (1979). The element of this definition that will generally be absent from a commodities futures trading account is the requirement of a common enterprise.

A common enterprise is "one in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or of third parties." *Brodt v. Bache & Co.*, 595 F.2d at 460 (quoting *SEC v. Glenn W. Turner Enterprises*, 474 F.2d 476, 482 n.7 (9th Cir.), cert. denied, 414 U.S. 821 (1973)). Some courts require a pooling of investments, termed horizontal commonality, in order to have a common enterprise. *E.g., Hirk v. Agri-Research Council, Inc.*, 561 F.2d 96, 101 (7th Cir. 1977). This circuit, however, requires only vertical commonality: that the investor and the promoter be engaged in a common enterprise. *Brodt v. Bache & Co.*, 595 F.2d at 460-461; *Hector v. Wiens*, 533 F.2d 429, 433 (9th Cir. 1976).

In *Brodt*, this court rejected a claim that a discretionary commodities trading account constituted a common enterprise under circumstances that we find undistinguishable from those of this case. We stated:

[T]he success or failure of Bache as a brokerage house does not correlate with individual investor profit or loss. On the contrary, Bache could reap large commissions for itself and be characterized as successful, while the individual accounts could be wiped out. Here, strong efforts by Bache will not guarantee a return nor will Bache's success necessarily mean a corresponding success for Brodt. Weak efforts or failure by Bache will deprive Brodt of potential gains but will not necessarily mean that he will suffer serious losses. Thus, since there is no direct correlation on either the success or failure side, we hold that there is no common enterprise between Bache and Brodt.

595 F.2d at 461. "Merely furnishing investment counsel to another for a commission, even when done by way of a discretionary commodities account, does not amount to a 'common enterprise.'" *Id.* at 462.

The Mordaunts argue that vertical commonality exists by reason of the fact that the success or failure of the investments collectively is essentially dependent upon promoter expertise. This contention, based on the reasoning in *SEC v. Continental Commodities Corp.*, 497 F.2d 516 (5th Cir. 1974), was considered and rejected in *Brodt*. Under *Brodt*, there is no common enterprise unless there is some direct relation between the success or failure of the promoter and that of his investors. In this case, as in *Brodt*, such direct relation is lacking. Incomco earned commissions totalling \$27,190.00 on the Mordaunts' accounts during the period in which the Mordaunts' collective losses amounted to \$27,385.03. In sum, these discretionary commodities trading accounts do not constitute common enterprises, and therefore are not securities under 15 U.S.C. § 77(b). Accordingly, the judgment of the district court is REVERSED.

#### FOOTNOTE

1/ Hereinafter, all appellants will be referred to as "Incomco."

#### APPENDIX D

#### UNITED STATES DISTRICT COURT FOR THE DISTRICT OF IDAHO

MONTE R. MORDAUNT, an individual, and Dorothy Mordaunt, an individual, Plaintiffs/Appellees,	No. 3-75-68  JUDGMENT
vs.	FILED
INCOMCO, a partnership, MYROM J. SMITH and PHILIP M. SMITH, general partners, Defendants/Appellants.	U.S. District Court District of Idaho SEP 8, 1978 Jerry L. Clapp, Clerk

This cause came on for bench trial on July 20, 1978, at Moscow, Idaho. A jury was waived by stipulation. The parties were present and represented by counsel of record. Documentary and oral evidence was received, and at the close thereof oral argument was heard. The Court has entered formal Findings of Fact and Conclusions of Law in favor of the plaintiffs and against the defendants.

IT IS ORDERED, ADJUDGED, AND DECREED:

1. That judgment is entered in favor of the plaintiff Monte R. Mordaunt and against the defendants, jointly and severally, in the sum of \$17,160.00, with simple interest at the rate of six percent per annum thereon in the sum of \$4,447.54, plus attorneys' fees in the sum of \$3,600.00, together with his costs reasonably incurred herein.

2. That judgment is entered in favor of the plaintiff Dorothy Mordaunt and against the defendants, jointly and severally, in the sum of \$9,775.03, with simple interest thereon at the rate of six percent per annum in the sum of \$2,287.31, plus attorneys' fees in the sum of \$2,000.00, together with her reasonable costs incurred herein.

3. The Counterclaim of the defendants is dismissed with prejudice.

DATED this 8th day of September, 1978.

/s/ Ray McNichols  
Ray McNichols, Chief  
Judge  
United States District  
Court

## APPENDIX E

### UNITED STATES DISTRICT COURT FOR THE DISTRICT OF IDAHO

MONTE R. MORDAUNT, an individual,  
and Dorothy Mordaunt, an individual,

Plaintiffs/Appellees,

vs.

INCOMCO, a partnership, MYRON J.  
SMITH and PHILIP M. SMITH, general  
partners,

Defendants/Appellants.

No. 3-75-68

FINDINGS OF  
FACT AND  
CONCLUSIONS  
OF LAW

FILED  
U.S. District  
Court District of  
Idaho  
SEP 8, 1978  
Jerry L. Clapp,  
Clerk

This cause came on for bench trial on July 20, 1978, at Moscow, Idaho. The parties were present and represented by counsel of record. Documentary and oral evidence was received and at the close thereof oral argument was heard. Proposed Findings of Fact and Conclusions of Law were solicited by the Court.

Parties have supplied the Court with Proposed Findings of Fact and Conclusions of Law which have been carefully considered and found by the Court to be most helpful. The matter is now fully submitted and ripe for determination. The Court, being fully advised, finds and concludes as follows:

#### FINDINGS OF FACT

The Court enters the following Findings of Fact:

1. The controversy arises under the provisions of: 15 U.S.C. § 77a, *et seq.*; 15 U.S.C. § 78a *et seq.*; Rule 10b-5, Rules of the Securities & Exchange Commission; and the provisions of the Idaho Securities Act, Idaho Code 30-1402, *et seq.*

2. 7 U.S.C. § 18 adopted by Congress on October 23, 1974,

providing a procedure for bringing complaints before the Commodities Futures Trading Commission, has a delayed effective date to January 23, 1976. The instant case was filed on October 16, 1975.

3. Plaintiffs, Monte R. Mordaunt and Dorothy Mordaunt, son and mother, respectively, are residents and citizens of the State of Idaho. Defendant Incomco was at all times relevant to this matter a partnership with its principal place of business in the State of New York. The individual defendants, Myron J. Smith and Philip M. Smith, father and son, respectively, were at all times here relevant the only partners in Incomco and were residents and citizens of the State of New York.

4. In May or June of 1974 plaintiff received, via U. S. mails, a copy of the May 1974 issue of *REASON* Magazine and read a paid advertisement therein concerning Incomco and its brokerage services which advertisement was placed therein by the defendants.

5. At sometime in the summer of 1974, plaintiff Monte Mordaunt received a mailing from a third party recommending Incomco as a brokerage firm utilizing a computer design method of commodities trading which method had been tested over a 15-year history of such trading. Enclosed in the letter was a printed card designed to be filled out and mailed to one Dennis Turner, an employee of the defendants, in order to request additional information about Incomco.

6. Plaintiff Monte Mordaunt completed and mailed the card to Turner. Shortly thereafter plaintiff Monte Mordaunt received, through the mail, a number of advertising brochures admittedly prepared by the defendants. These brochures were admitted into evidence.

7. Plaintiff Monte Mordaunt talked on the long distance telephone with the defendant Philip M. Smith on several occasions in the early fall of 1974, on which occasions Smith urged him to enter a contract and send in money to Incomco.

8. Plaintiff Dorothy Mordaunt read the advertising sent by the defendants to her son and was by him advised as to the context of the telephone conversations.

9. In reliance upon the representations of the defendants

and the advertising brochures and phone calls, plaintiff Monte Mordaunt in November and December of 1974 sent checks through the mail payable to the defendants in the total sum of \$32,610.00.

10. In reliance upon the representations of the defendants in the advertising brochures, the plaintiff Dorothy Mordaunt, in January 1975, sent a check through the mails payable to the defendants in the sum of \$14,349.00.

11. At the time each plaintiff forwarded his or her check to the defendants, each executed and forwarded a form of contract furnished by the defendants. Copies of these agreements were received in evidence.

12. Under the arrangement between the parties, as it existed at the time plaintiffs delivered their money to the defendants, plaintiffs invested their funds and defendant had the discretion to utilize the funds to trade in the commodities market. Defendants had a large number of such accounts and purchased a number of commodity "contracts" at one time which were then specifically assigned to the account of an individual investor and so reported to the investor. Profits to investors and consequent additional commissions to the defendants depended solely upon the skill and efforts of the defendants in predicting the market.

13. Some substantial profits were initially reported on plaintiff Monte Mordaunt's account, but by the spring of 1975 both accounts had balances less than the original investment. On May 31, 1975 plaintiffs canceled the agreement. Defendants refunded to the plaintiff Monte Mordaunt the sum of \$15,000.00, being \$17,610.00 less than his investment. Defendants refunded to the plaintiff Dorothy Mordaunt the sum of \$4,573.97, being \$9,775.03 less than her investment.

14. Defendants were not at any time relevant hereto registered security dealers or agents under the Securities Acts of the United States or of the State of Idaho. The Incomco Investment Program was not registered as a security.

15. Defendant Philip Smith testified that the large majority of investors in commodity trading lost money and that a relatively minor number of investors incurred profits, often of a very substantial nature.

16. The advertising material sent by the defendants to the plaintiffs and admitted into evidence in this case contained, among others, the following false and misleading information:

- (a) it was broadly implied that Incomco had been in business as a registered commission merchant trading in commodities for a period of fifteen years;
- (b) it was clearly stated that Incomco had developed and tested a unique computerized management program which had produced highly successful results in commodity trading; and
- (c) it was implied that, by the use of Incomco computerized trading methods, profits from 100% to 200% annually might be expected.

17. The evidence discloses, relative to the above:

- (a) that Incomco was first formed and registered as a commissioned merchant in December 1973, about six months before the advertising brochures were received and read by the plaintiffs;
- (b) that Incomco had no computer of its own and the only computerized information utilized by Incomco was by way of a subscription to a reporting service generally available to anyone willing to pay a relatively modest fee; and
- (c) that most of the people investing in commodity trading could expect to lose money.

18. A reasonably prudent investor would consider information as to: (1) the length of time a commission agent had been in business; (2) the claimed successful and unique computerized trading method; and (3) the expectation of high profits as important considerations in making a determination as to whether or not to invest.

### FINDING

19. Interest, if allowed at 6% per annum, computed as simple interest is to be computed as follows:

*Plaintiff Monte Mordaunt:*

\$29,610.00 from 1/7/74 to 6/2/75 (187 days or 51% of 1 year) at 6%	\$906.06
\$3,000.00 from 12/10/74 to 6/2/75 (174 days or 48% of 1 year) at 6%	86.40
\$17,610 from 6/2/75 to 9/8/78 (date of judgment) (1194 days or 3.27 years) at 6%	3,455.08
Total simple interest	\$4,447.54

*Plaintiff Dorothy Mordaunt:*

\$14,349.00 from 1/3/75 to 6/24/75 (172 days or 47% of year) at 6%	\$404.64
\$9,775.03 from 6/24/75 to 9/8/78 (date of judgment)(1172 days or 3.21 years at 6%	1,882.67
Total simple interest	\$2,287.31

20. In considering what amount is reasonable as and for attorneys' fees, if the same are to be allowed in this case, I have taken into account the complexity of the case, the usual time and effort necessary to prepare for and try a case of this kind, the customary fees charged by attorneys in the area, the competence of counsel, and the successful result. I find, based upon my experience in this jurisdiction and in the trial of such cases, and after a careful review of the entire file, that a reasonable sum to be allowed to the plaintiff Monte R. Mordaunt is the sum of \$3,600.00, and that a reasonable sum for

attorneys' fees to be allowed to the plaintiff Dorothy Mordaunt is the sum of \$2,000.00.

21. Defendants have failed to prove a right to relief under their Counterclaim.

From the foregoing facts found, the Court concludes as a matter of law, as follows:

#### CONCLUSIONS OF LAW

1. That the Court has jurisdiction over the controversy and that venue in this Court is proper.

2. That the transactions between the parties constituted investment contracts for the purchase of securities under the federal and State of Idaho securities acts.

3. That the defendants sold to the plaintiffs unregistered securities in violation of the said federal and state security acts.

4. That the information contained in the advertising sales documents sent by the defendants to the plaintiffs contained false and misleading statements as to material facts in violation of the said federal and state security acts and Rule 10b-5 of the Securities & Exchange Commission.

5. That plaintiffs reasonably relied upon said false and misleading statements of material facts to their damage.

6. That plaintiffs are entitled to have the aforementioned investment contract rescinded and judgment entered for them for the balance of their investment.

7. Defendants' Counterclaim must be dismissed.

8. Plaintiffs are entitled to an allowance of attorneys' fees as follows:

Plaintiff Monte R. Mordaunt the sum of  
\$3,600.00;

Plaintiff Dorothy Mordaunt the sum of  
\$2,000.00.

9. The plaintiff Monte R. Mordaunt is entitled to judgment against the defendants, jointly and severally, in the sum of \$17,610.00, with simple interest at the rate of six percent per annum thereon in the sum of \$4,447.54, plus attorneys' fees in the sum of \$3,600.00, together with his costs reasonably in-

curred herein.

10. Plaintiff Dorothy Mordaunt is entitled to judgment against the defendants, jointly and severally, in the sum of \$9,775.03, with simple interest thereon at the rate of six percent per annum in the sum of \$2,287.31, plus attorneys' fees in the sum of \$2,000.00, together with her reasonable costs incurred herein.

DATED this 8th day of September, 1978.

/s/ Ray McNichols  
Ray McNichols, Chief  
Judge  
United States District  
Court

## APPENDIX F

UNITED STATES DISTRICT  
COURT FOR THE DISTRICT OF IDAHO

MONTE R. MORDAUNT, an individual,  
and Dorothy Mordaunt, an individual,

Plaintiffs/Appellees,

vs.

INCOMCO, a partnership, MYRON J.  
SMITH and PHILIP M. SMITH, general  
partners,

Defendants/Appellants.

No. 3-75-68

ORDER DENY-  
ING MOTION  
TO AMEND  
FINDINGS OF  
FACT OR CON-  
CLUSIONS OF  
LAW OR, IN  
THE ALTER-  
NATIVE, FOR  
A NEW TRIAL

FILED  
U.S. District  
Court District  
of Idaho  
SEP 22, 1978  
Jerry L. Clapp,  
Clerk

The Court having entered the Findings of Fact and Conclusions of Law and a Judgment adverse to the defendants, defendants have now moved for an amendment to the Findings of Fact and Conclusions of Law. The purpose of these amendments is to raise a question of the Court's jurisdiction which has been heretofore fully determined by the Court adversely to the defendant. No new matter is raised.

Additionally, a new trial is requested on the basis that the evidence is insufficient to support the Judgment. Again, this matter has been previously seriously considered by the Court.

Neither of the alternative motions has merit

IT IS THEREFORE ORDERED:

That the Motion of the Defendants to Amend the Findings of Fact and Conclusions of Law, or in the Alternative, for New Trial, are, and each is, DENIED.

/s/ Ray McNichols  
Ray McNichols, Chief  
Judge  
United States District  
Court

**OPINION**

**SUPREME COURT OF THE UNITED STATES**

**MONTE R. MORDAUNT AND DOROTHY MORDAUNT v.  
INCOMCO ET AL.**

**ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED  
STATES COURT OF APPEALS FOR THE NINTH CIRCUIT**

No. 83-2025. Decided January 7, 1985

The petition for a writ of certiorari is denied.

JUSTICE WHITE, with whom THE CHIEF JUSTICE and JUSTICE BRENNAN join, dissenting.

Responding to a magazine advertisement, petitioners entered into discretionary commodities futures contracts with respondents. Petitioners gave respondents over \$45,000 to invest in the commodities futures market. Investment decisions were left entirely to respondents, who received a commission for each transaction they conducted. The accounts were soon worth far less than \$45,000, and petitioners cancelled the agreements. They then brought the present action in Federal District Court, alleging violations of federal and state securities laws. The District Court entered judgment for petitioners, concluding that the advertisement had been false and misleading and that the accounts constituted "investment contracts" within the meaning of the federal securities laws. See 15 U. S. C. § 77(b). The Court of Appeals reversed. 686 F. 2d 815 (1982). It held that because respondents' prosperity did not hinge on the success or failure of petitioners' investments—respondents earned \$20,000 in commissions while petitioners were losing \$27,000—the required "common enterprise" was lacking.

Section 2(1) of the Securities Act of 1933 defines "security" to include an "investment contract." 15 U. S. C. § 77(b). Forty years ago this Court held that an "investment contract" is a "contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party . . . ." *S. E. C. v. Howey Co.*, 328 U. S. 293, 298-299

(1946). The lower courts have disagreed over whether a trading account like that involved here satisfies the requirement of a "common enterprise." Some require a pooling of investments—horizontal commonality. See *Curran v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 622 F. 2d 216 (CA6 1980), *aff'd* on other grounds, 456 U. S. 353 (1982); *Hirk v. Agri-Research Council, Inc.*, 561 F. 2d 96 (CA7 1977); *Wasnowic v. Chicago Board of Trade*, 352 F. Supp. 1066 (MD Pa. 1972), *aff'd*, 491 F. 2d 752 (CA3 1973), *cert. denied*, 416 U. S. 994 (1974). Under this approach, discretionary futures contracts do not qualify as securities. Other courts require only the existence of a relationship between an investor and a broker—vertical commonality—and reach the opposite result. *S. E. C. v. Continental Commodities Corp.*, 497 F. 2d 516 (CA5 1974); *cf. Commercial Iron & Metal Co. v. Bache & Co.*, 478 F. 2d 39 (CA10 1973), *cert. denied*, 440 U. S. 914 (1979); *Booth v. Peavey Co. Commodities Services*, 430 F. 2d 132 (CA8 1970). The SEC has in the past taken the position that discretionary commodities futures contracts are securities. *In re Carlson*, 15 SEC Docket 104 (Dec. 12, 1977) (horizontal pooling promised but not implemented); see also *SEC v. Continental Commodities Corp.*, *supra*.

Like the Fifth Circuit, the Ninth Circuit has rejected the horizontal commonality requirement. *E.g.*, *Meyer v. Thomson & McKinnon Auchincloss Kohlmeyer, Inc.*, 686 F. 2d 818 (1982), *cert. denied*, — U. S. — (1983); *Brodit v. Bache & Co.*, 595 F. 2d 459, 461 (1978). However, its conception of vertical commonality is more stringent. The Fifth Circuit has stated that the "critical inquiry" is whether there is "promoter dominance," that is, "whether the fortuity of the investments collectively is essentially dependent upon promoter expertise." *S. E. C. v. Continental Commodities Corp.*, *supra*, at 522 and n. 12; see also *Taylor v. Bear Stearns & Co.*, 572 F. Supp. 667, 671 (ND Ga. 1983). Under the Ninth Circuit's rule it is not enough that the promoter has control of the investments. "Vertical commonality" also re-

quires a correlation between the success of the promoter and that of the accounts themselves. See 686 F. 2d, at 817; *Brodit v. Bache & Co.*, *supra*, at 462.

The importance of this conflict is not limited to the classification of discretionary commodities futures contracts. In related areas the lower courts are similarly divided as to whether *Howey* requires vertical or horizontal commonality. For example, the Ninth Circuit relied on its decision in this case in concluding that vertical commonality rendered a sale/leaseback transaction a security. *United States v. Jones*, 712 F. 2d 1316, *cert. denied*, — U. S. — (1983). In contrast, the Sixth Circuit has relied on *Curran*, *supra*, in applying a horizontal commonality test to a loan participation agreement. *Union Planters National Bank v. Commercial Credit Business Loans, Inc.*, 651 F. 2d 1174, *cert. denied*, 454 U. S. 1124 (1981).

In light of the clear and significant split in the Circuits, I would grant certiorari.